

ICPS newsletter

Grain crisis could have been avoided

The peak of the grain crisis in Ukraine has passed, along with the period of agitated demand, and prices in the wholesale wheat market are gradually coming down. Finally, the following questions remain: what caused the crisis, could it have been avoided in time, and what government strategy is needed not to create conditions for further crises?

The first signs of a crisis in the food grain market appeared at the end of March 2003. Domestic wheat supply fell substantially and triggered price growth almost doubling that during the harvesting period of 2002. The 2002 grain crop was reported at 38.8 million tons, with average domestic consumption being 25–26 million tons a year and the rest of the grain available for export. However, already after 10.27 million tons of grain had been exported by the end of Q1'03, the food grain market began to show signs of a deficit. In our opinion, this situation was caused by:

- negative expectations of grain producers concerning the 2003 harvest, the necessity to resow substantial areas, and the late sowing campaign due to unfavourable weather conditions that restrained producers from selling grain;
- substantial growth particularly in the export of food grain in MY'02/03;
- overstatement of grain production by individual enterprises and officials and, as a result, inflated data on the 2002 harvest.

We believe that the shortage in the grain market could have been avoided if there had been an effective government policy in the sector. Given the ineffectiveness of stabilising mechanisms, farmers have no alternatives but to export the grain, as not all of them have access to grain elevators¹. The following areas of government policy require adjustment:

- introduction of mechanisms for internal stabilisation of the grain supply and prices for it (pledged and intervention procurements);

¹ According to the data of APK-Inform from 15 May 2003, only 30% of grain producers are able to store grain for 3–4 months. Over 60% of producers sell grain straight off the field.

- discontinuation of the binding of loan interest refunds to the budget year, as the necessity to repay loans before the end of the year pressures farmers to sell their grain at a disadvantageous time, when prices are low;
- development of forward and futures trading in grain;
- expansion of farmers' access to grain elevators, particularly those belonging to the Khlib Ukrainy SJSC (40 elevators, including 2 harbour ones), by means of restructuring the latter;
- reforming the State Reserve and strengthening control over the activity of officials with access to reserved grain and exercising its procurement.

At the same time, we do not believe the intensification of administrative interference in the grain market to be advisable (increasing the number of check-ups, prohibiting inter-oblast trade). Such measures would increase the risks of grain growing and bring down the investment attractiveness of the sector.

Proper government policy will prevent further crises

Sharp increases in the price of flour and cereals in the last ten days of June 2003, caused by market player scheming and a rush on the part of the population, led to social welfare losses. Authorities made active attempts to stabilise the markets, mainly by means of administrative-organisational measures. Yet the lack of a long-term strategy for stabilisation cannot help the Ukrainian government to avoid substantial seasonal instability of prices. The negative outcomes of such instability are:

- high risks of investment and reduction of investment recoupment margins, which lowers incentives to invest;

- redistribution of revenues among creditors and debtors;
- increased risks of making mistakes during pricing, as it is not known whether instability of prices is a trend or just a temporary factor.

Key reasons behind the price fluctuations include the following:

- fragmentary and incomplete information. The lack of information about stocks of grain, flour, and cereals, as well as the absence of proper expectations with regard to prices on them have led to losses for market players; households react to temporary deficits, while trading enterprises lose potential long-term profits because of the shortage of information about what is in demand;
- ineffective market functioning. Market infrastructure, which should act as a mechanism for price-setting and forming expectations, hardly works or is nonexistent (no exchange or futures operations, etc.). The dearth of information results in a retarded reaction to changes in demand, because of the lack of operative stocks of commodities at both private operators and the government, the latter of which is thus unable to resort to interventions in cases of market mechanism failure (which it should do);
- the absence of a consistent long-term government policy of market stabilisation, and a delayed reaction to market failures;

- one-sidedness of non-market methods of influencing the market.

We believe that the government has to work out a single approach to market regulation with a clear seasonal cycle:

- promoting competition, de-monopolisation, and prevention of conspiracy;
- development of infrastructure and making information more transparent;
- increased spending on short-term interventions that may cut long-term losses due to market instability.■

We wish you a pleasant vacation!

The ICPS Newsletter team will take a vacation break, and wishes all its readers a good summer. See you in September!